

INDIANA DEPARTMENT OF STATE REVENUE

REVENUE RULING #2001-10ST

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ISSUE

Sales/Use Tax – Taxability and Reporting Requirements Concerning a Federal “Like-Kind Exchange” Transaction

Authority: IC 6-2.5-2-1, IC 6-2.5-4-1, IC 6-2.5-9-3, Rule 45 IAC 2.2-3-5, IC 6-2.5-5-8

The Taxpayer requests the Department to rule on the application of, and reporting requirements for, sales/use tax on three scenarios concerning a federal “like-kind exchange” transaction.

STATEMENT OF FACTS

Taxpayer is a lessor of tangible personal property (i.e., motor vehicles). The transaction at issue involves the typical purchase, lease, and sale of motor vehicles as modified to qualify under Internal Revenue Code (“IRC”) Section 1031. The Internal Revenue Service has ruled that exchanges of property (including rental property) by a corporation through an intermediary can qualify under IRC Section 1031 as tax-free like-kind exchanges for federal income tax purposes. The Taxpayer has entered into an agreement with an “Intermediary” that qualifies for the federal tax-free like-kind exchange treatment.

During the course of a leasing transaction, events can be divided into the following three segments or categories: (a) the acquisition of the property by the lessor; (b) the term of the lease; and (c) the disposition of the property by the lessor at the conclusion of the lease term. Simply stated, the lease is born, it lives for a period of time, and it terminates. The complexities of IRC Section 1031 only impact the lease transaction(s) at issue when the motor vehicle is (a) sold at the conclusion of the lease, and (b) when a new or replacement vehicle is acquired.

The IRC Section 1031 transaction does not impact the relationship between the lessor and lessee during the term of the lease. The lessee will continue to remit all payments

during the term of the lease to the lessor. The lease payments will continue as they currently exist, and the lessor will continue to issue invoices to the lessee. The only change in business operation for the proposed IRC Section 1031 transaction is upon (1) the sale of the motor vehicle at the conclusion of the lease, and (2) the purchase of a newly-leased motor vehicle by the lessor.

On termination of the lease, Taxpayer disposes of (i.e., sells) the vehicles in one of several ways: (1) the Taxpayer directly sells the motor vehicle to the lessee through the purchase option of the lease; (2) the Taxpayer sells the motor vehicle to the dealer for resale to the lessee, who exercises the purchase option; (3) the Taxpayer sells the motor vehicle directly to the dealer for resale to someone other than the lessee; or (4) the Taxpayer sells the motor vehicle at auction to a dealer for purposes of resale. Under any of these described scenarios, the Taxpayer will dispose of the vehicles ("Relinquished Property") at the termination of the lease through the Intermediary. The Intermediary has been assigned the Taxpayer's rights (but not its obligations) with respect to the sale of the Relinquished Property at the termination of the lease. The property is sold in accordance with the Taxpayer's directions and instructions either to (a) the lessee, or (b) the dealer for resale. In the first instance, the transaction would be assumed taxable for sales and use tax purposes (e.g., sale to consumer). In the second instance, the transaction would be generally assumed not taxable for sales and use tax purposes (e.g., exempt for resale). The Taxpayer controls the disposition of the relinquished property, and the title to the property is transferred directly from the Taxpayer to the purchaser. The proceeds from the sale are received in a Taxpayer and Intermediary joint bank account ("Account") which restricts the Taxpayer's right to receive or otherwise obtain the immediate benefit of the proceeds. The Intermediary merely serves as a qualified Intermediary for federal Like-kind Exchange purposes, but does not change the basic character of the transaction. For this service, the Intermediary receives a fee.

The Taxpayer also acquires "Replacement Property" using the services of the Intermediary. As with the Relinquished Property, the Intermediary has been assigned the Taxpayer's rights (but not its obligations) with respect to the acquisition of newly leased vehicles ("Replacement Property"). At the Taxpayer's direction, the Intermediary pays for the Replacement Property out of the Account with funds from the sale of Relinquished Property. If there is a shortfall (the funds in the Account are less than the purchase price of Replacement Property), the Taxpayer will pay the difference. Replacement Property relinquished in a particular exchange is identified within 45 days of the sale of the Relinquished Property. If an exchange does not occur within the shorter of (a) 180 days or (b) the due date, including extensions, of the Taxpayer's federal income tax return, the Taxpayer will recognize gain on the exchange for federal income tax purposes. Again, as in the sale of Relinquished Property, the role of the Intermediary in the purchase of the Replacement Property is merely to provide a service to the Taxpayer. The title for the motor vehicle is transferred directly from the dealer to the Taxpayer and never rests with the Intermediary.

Scenarios at Issue for Sales and Use Tax Purposes

1. Sale of Motor Vehicle to a Taxable Individual or Other Taxable Entity

An individual purchaser (which for the purposes of the ruling is defined as any person or other legal entity) may exercise an option to purchase the leased vehicle at the conclusion of the lease term. By way of comparison, in a typical taxable scenario (not an IRC Section 1031 transaction), the Taxpayer (i.e., lessor) (a) sells a motor vehicle, (b) collects the payment (e.g., purchase price plus tax), and (c) remits the appropriate sales and use tax on the transaction, in exchange for (d) the title to the motor vehicle. However, the individual purchaser will be directed to (b) remit their payment for the vehicle to the Account. For sales and use tax purposes, the Taxpayer will continue to document, report, and remit all taxes due on the transaction. The reporting of the transaction will continue to follow the flow of the documentation (i.e., title) at the Department of Revenue.

It should be noted that the Taxpayer does not typically sell the leased vehicle directly to the lessee at the conclusion of the lease. With some exceptions, the Taxpayer usually sells the leased vehicle to the dealer who resells such vehicle.

2. Sale of Motor Vehicle to a Nontaxable Dealer

The lessor, at the conclusion of the lease sells the used motor vehicle to a dealer or another nontaxable reseller. The dealer may subsequently sell the vehicle to the lessee or to another third party. By way of comparison, in a typical nontaxable scenario (not an IRC Section 1031 transaction) the Taxpayer (i.e., lessor) (a) sells a motor vehicle, (b) receives payment (e.g., purchase price without tax) and a resale exemption, and (c) does not remit sales and use tax on the transaction, in exchange for (d) the title to the motor vehicle. In a qualified IRC Section 1031 transaction, the Taxpayer will continue to (a) sell a motor vehicle, (b) receive a resale certificate, and (c) not remit sales and use tax, in exchange for (d) the title to the motor vehicle. However, as noted above, the dealer will be directed to remit their payment for the vehicle to the Account. For sales and use tax purposes, the Taxpayer will continue to document and report the non-taxability of the transaction. The reporting of the transaction will continue to follow the flow of the documentation (i.e., title) at the Department of Revenue.

3. Purchase of a Motor Vehicle for Purposes of Leasing

In a situation where the lessor purchases tangible personal property (i.e., motor vehicles) and the lessee pays tax based upon the rental costs, typically the lessor acquires the property without being subject to sales or use tax (i.e., resale). Typically the Taxpayer (i.e., lessor) (a) purchases the vehicle from the seller, (b) supplies a written statement that the merchandise is being purchased for resale, and (c) receives title for the motor vehicle. In an IRC Section 1031 transaction, the Taxpayer will direct the Intermediary to make payment from the Account to the seller. The Taxpayer will continue to (b) supply a valid sale for resale exemption to

the seller and (c) receive title. The related lease of the motor vehicle will remain unchanged, and the lessor will continue to remit all rental taxes due upon the lease payments.

DISCUSSION

IC 6-2.5-2-1 imposes sales tax on retail transactions made in Indiana. A “retail merchant” is a person who makes retail transactions by engaging in selling at retail. A person is “engaged in selling at retail” when, in the ordinary course of regularly conducted trade or business, the person acquires tangible personal property for the purpose of resale and transfers that property to another person for consideration (IC 6-2.5-4-1). The purchaser is liable for the tax on the transaction and shall pay the tax to the retail merchant as a separate added amount to the consideration of the transaction. The retail merchant must collect and remit the tax as an agent of the Department (IC 6-2.5-2-1 and IC 6-2.5-9-3).

The sale of any vehicle required to be licensed by Indiana for highway use in the state shall constitute selling at retail and is subject to sales/use tax unless the purchaser is entitled to an exemption (Rule 45 IAC 2.2-3-5). Transactions involving tangible personal property are exempt from sales/use tax if the person acquiring the property acquires it for resale, rental or leasing in the ordinary course of business without changing the form of the property (IC 6-2.5-5-8).

It is clear then, the three scenarios at issue fall within the ambit of the above statutes and regulation. The Taxpayer has correctly interpreted and applied the statutes and regulation to the three scenarios. The introduction of the Intermediary into the three scenarios has no effect on the responsibilities of the Taxpayer for sales/use tax collection and reporting.

RULING

The Department rules that:

1. The sale of a motor vehicle at the conclusion of the lease (e.g., sale to the lessee) is a taxable transaction for sales and use tax purposes between the Taxpayer and the customer. The Taxpayer would be the party responsible for remittance of the appropriate sales or use tax to the State of Indiana. The required IRC Section 1031 payment to the Account, managed by an Intermediary, does not change the filing and payment process of the Taxpayer;
2. The sale of a motor vehicle at the conclusion of the lease (e.g., sale to a dealer) is a nontaxable transaction for sales and use tax purposes between the Taxpayer and the dealer, provided that the proper exemption certificates are issued. The required IRC Section 1031 payment to the Account, managed by an Intermediary, does not alter the reporting process of the Taxpayer; and

3. The purchase of a new motor vehicle (i.e., Replacement Property) for leasing operations is a nontaxable transaction, for sale and use tax purposes, between the Taxpayer and the dealer, pursuant to the proper completion of the resale exemption certificate. The required IRC Section 1031 payment from the Account, managed by an Intermediary, does not alter the reporting process of the seller.

CAVEAT

This ruling is issued to the taxpayer requesting it on the assumption that the taxpayer's facts and circumstances, as stated herein, are correct. If the facts and circumstances given are not correct, or if they change, then the taxpayer requesting this ruling may not rely on it. Other taxpayers with substantially identical factual situations, however, may rely on this ruling for informational purposes in preparing returns and making tax decisions. If a taxpayer relies on this ruling and the Department discovers, upon examination, that the fact situation of the taxpayer is different in any material respect from the facts and circumstances given in this ruling, then the ruling will not afford the taxpayer any protection. It should be noted that subsequent to the publication of this ruling, a change in a statute, a regulation, or case law could void the ruling. If this occurs, the ruling will not afford the taxpayer any protection.

Indiana Department of State Revenue